

DRAFT - MARCH 10, 2003

STATEMENT  
OF  
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ASSOCIATE LABORATORY DIRECTOR FOR ADMINISTRATION  
LOS ALAMOS NATIONAL LABORATORY

My name is Richard Marquez, and I am the Associate Laboratory Director for Administration, Los Alamos National Laboratory, a position I have held since February of 2002.

I am joined today by John Hernandez and Stan Hettich of the Laboratory's Business Operations Division, which reports to me.

I thank you for the opportunity to provide testimony regarding the procurement and property management issues reported in this and other public forums.

Virtually all of my career has been directly or indirectly related to the nuclear weapons complex and to federal resources management. Because of that, I keenly appreciate that the road to strong mission and program performance at a national laboratory leads through the effective and efficient buying of goods, services, construction, and equipment.

Within 90 days of beginning my assignment, I directed the development of a three-year strategic plan to address what I considered to be weaknesses surrounding the procurement function at the Laboratory. I did this after reviewing the internal and external audit reports on file and after considering some key metrics on volume of procurement activity versus staffing.

I was struck by the fact that from 1996 to 2002, the procurement volume had virtually doubled from \$620 million to well over \$1 billion. But I was concerned when I discovered that staffing over that same period had remained almost static. Moreover, attrition and leadership changes were continual. When I arrived at the Laboratory the third procurement director in a three-year time frame had only recently taken the helm.

I also found very critical audit reports that were somewhat dated and that reputedly had been responded to with corrective actions by management.

Of note, I also found 'Outstanding' performance evaluation ratings under the contract for procurement as well as virtually all business management functions, including property management.

In spite of what I regarded as somewhat conflicting indicators, it was my view then that the Laboratory's procurement function had not kept pace with the robust science and technical side of the house. That view, and my resolve to upgrade the procurement function, has only increased since that strategic plan was developed. What has changed is the understanding of the depth of the problems and the extent of commitment required to fix those problems---the diagnosis was for a tuneup and an overhaul is required.

As Bruce Darling testified to this Subcommittee two weeks ago, the University of California has taken a very active and strong role in correcting the deficiencies that have been reportedly publicly. I am heartened by the commitment and resolve that the University has shown in tackling the many issues we face. Coupled with Pete Nanos's leadership, I believe that we can and will make changes and that we can sustain those changes over time.

I am not surprised by the special inquiry of the DOE Office of Inspector General (OIG) in that it found no evidence of coverup regarding the problems at the Laboratory. However, I would like to address reported concerns and allegations that the Laboratory "observed" or even concealed issues regarding property management or procurement vulnerabilities.

### **Property Management**

In the January 28, 2003, DOE OIG report on their special inquiry of Los Alamos National Laboratory operations, the report concluded that the Laboratory took a number of actions that "observed" serious property management and security problems.

#### *Palmieri Memo Rescinded and Reissued*

One area of OIG concern involved the finding that the Laboratory "issued, then immediately rescinded without adequate explanation" a memorandum requiring corrective actions to address problems regarding the management of Government property. In the opinion of the OIG, this raised doubts about management's "commitment to address identified control weaknesses". The memorandum has also been the subject of various news media reports.

Let me list a quick chronology regarding that memorandum:

- The memorandum in question was issued by the former Laboratory Chief Financial Officer, Thomas Palmieri. Mr. Palmieri's memorandum was dated April 10, 2002, but not formally issued until April 18, when it was distributed via e-mail.
- The memorandum was retracted by Mr. Palmieri on April 19 as a result of direction I received from Joe Salgado, former Principal Deputy and Chief Operating Officer. He was sensitive to a wide-spread distribution of employees' names beyond those who had a need to know this information and, because of the importance of the subject, Mr. Salgado wanted a more formal 'top down' discussion and dissemination of the memorandum from me to each of the other Associate Laboratory Directors.
- With respect to his concern for a more formal distribution, on Sunday, April 28, I wrote an e-mail to the Laboratory's senior executive team in advance of an April 29 weekly senior executive meeting conducted by the Laboratory Director every Monday morning. The e-mail covered four topics, three of which were related to business and financial management, which I intended to discuss as agenda items for that meeting. The e-mail also included an advance copy of a memorandum that I formally distributed April 29.

- On April 29, I did, in fact, re-issue the memorandum to the Laboratory's senior executive team.

It is significant to note that, on the morning of April 29, prior to the senior executive team meeting, I forwarded my April 28 e-mail to Mr. Palmieri, his deputy Dennis Roybal, his chief of staff, and the Laboratory's two principal property managers, Allen Wallace and John Tapia. It should also be noted that the formal distribution of the April 29 memorandum also included those same individuals as well as the 60 Laboratory property administrators and the 120 Laboratory business team leaders deployed across the Laboratory.

#### *OIG Interview of Mr. Palmieri*

I mention this because Mr. Palmieri, when interviewed on December 18, apparently forgot that the memorandum had been re-issued and advised the OIG otherwise. I do not agree with the DOE OIG's conclusion that we "obscured" serious property management problems but it would appear that we did obscure the very serious manner in which we followed up on property management issues.

#### *The April 29 Memorandum*

My April 29 memorandum was virtually the same as the Palmieri memorandum except that each Laboratory Associate Director was given the relevant unlocated, lost, and stolen property lists for each Division that reported to him. It included the guidance that all reasonable efforts be made to locate such property and provided that, after review of the circumstances for the loss, managers "may deem that individuals should be held accountable or otherwise disciplined".

Attached to the memorandum were the same four reporting mechanisms intended by the Palmieri memorandum:

- missed assignment of property to accountability statements within 60 days as required by Laboratory policy;
- lost and stolen property per Division;
- inventory exceptions, by which we intended to report discrepancies between assignment of property and exceptions taken by the assigned custodian; and,
- trend reports.

Of these four reports, the Property Management Group did issue the 60-day assignment report and the inventory exceptions report was produced in accordance with Appendix F requirements of the prime contract. The property group produced trend reports on request of management. The lost and stolen report was sent with my April 29 memorandum. Also, I received two corrective actions plans, one for a Division with unusually high levels of property unaccounted for and one for an Associate Director covering all of the Divisions reporting to him.

#### *The Year-End Results*

I think any fair assessment of the results of the re-issued memorandum and the Property Management Group's follow up actions would conclude that the memorandum was highly effective in raising the management level of attention to property management.

At the time the memorandum was distributed, the cost of 'unlocated' property in the inventory was \$735 thousand and by September 30, 2002, that number was down to \$484 thousand. With respect to lost or stolen property, we dropped from \$533 thousand at the time of the memorandum to \$206 thousand by September 30, 2002.

#### *Clarification of Reporting Lost and Stolen Property*

The DOE OIG special inquiry found a substantial degree of "dysfunction" with respect to roles and responsibilities regarding loss and stolen property. As indicated by Mr. Darling in his February 26 testimony, the Laboratory has clarified that lost and stolen property is to be reported to the Office of Audits and Assessments, which now directly reports to the University of California Office of the President.

#### **The Mesa Contract**

The next issue I would like to address is the Mesa Contract and the involvement by people in the Business Operations Division. That involvement was two fold. One, Business Operations Division administered the contract. And, two, personnel in Business Operations Division supported Security Division and the Federal Bureau of Investigation in the criminal investigation of property purchased under that contract for personal use.

Some time in mid-to-late July, 2002, Joe Salgado, then Principal Deputy and Chief Operating Officer of the Los Alamos National Laboratory, advised me that the Federal Bureau of Investigation (FBI) had begun an investigation regarding alleged criminal improprieties in connection with purchases made under the Mesa Contract. Mr. Salgado did not share with me many details but advised me that my 'need to know' was in order to make sure the FBI and our security organization had appropriate support from the Business Operations Division in terms of getting access to contractual records.

#### *Security Division and FBI investigation*

Shortly after this meeting, Stan Busboom, then Security Division Director for the Laboratory, called me and requested support from John Tapia, Deputy Group Leader for Property Management. Mr. Busboom advised me that John's expertise in property management would be useful to Glen Walp and Busboom as they worked with the FBI on the TA33 case. I agreed to that support and notified John Tapia that he was to provide any support required from the Security Division.

To my knowledge, Mr. Tapia provided excellent support to Mr. Walp, Mr. Doran, Mr. Sprouse, Mr. Tucker, and even the FBI agent in charge. According to Mr. Tapia, his support included a description of the buying and property functions, copies of the Mesa Contract, credit card transactions, and Local Vendor Agreement records.

Because Mr. Tapia required information from the procurement organization as well as his own property management group, Mr. Tapia would call me and ask me to advise procurement officials that he was authorized to request business records. I did that and, so far as was ever reported to me, the security investigation on the TA33 case was fully supported by the Business Operations Division and the staff in my directorate.

### *Procurement Background*

I would like to make some observations about how the Mesa Equipment & Supply contract got to where it was and where the contract stands now.

Before it had its own contract with the Laboratory, Mesa was a supplier to the Laboratory as a sub-tier contractor to a Just in Time vendor known as Frank's Supply. Their volume of sales under the Just in Time arrangement was reportedly on the average of \$400 thousand per year.

The Mesa Contract was awarded by the Laboratory as a small business contract on November 1, 2000, with a not-to-exceed ceiling of \$100 thousand. On March 6, 2001, the contract was modified to increase the ceiling to \$500 thousand. On January 23, 2002, the fourth and final change to the dollar ceiling increased the ceiling to \$2.7 million. In sixteen months, the contract had grown from \$100 thousand to \$2.7 million.

The contractual arrangement is referred to as a Blanket Order Agreement which, in simple terms, means that employees with purchase authorization across the Laboratory can make purchases under the contract.

As I have indicated to the staff of this Subcommittee in their field investigations, I cannot defend the manner in which this contract was administered. I know that our procurement personnel questioned some individual purchases with at least one of the individuals who was terminated and is under FBI investigation. But we could have, and should have, done more.

I was advised by Laboratory Counsel to leave the contract open pending the FBI field investigation. The contract term expired October 31, 2002. The FBI executed search warrants in this case on October 31, 2002.

### *Follow up Actions*

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#### *Follow up Actions*

- We have reassigned the Team Leader who had direct oversight of the administrator of that contract. John Hernandez was that Team Leader and he is here with me today. Similar to the Team Leader who had oversight of our purchase card program, Mr. Hernandez wrote a letter to his management acknowledging his accountability. By his own admission, Mr. Hernandez' skills are more suited to major procurement staff work than to supervision and management and his long career at the Laboratory reflects this.
- I plan to determine the amount that represents fraudulent transactions and, to the extent they are not within the scope of the Mesa contract, I plan to present a claim to that firm in that amount. For those items for which I cannot substantiate that they are out of scope, then we will go through a process of finding items of use by our facilities support contractor or by the Laboratory. After that, we would consider those items unallowable costs and so advise the NNSA Contracting Officer.
- Finally, as reported by Mr. Darling, the University of California has engaged the Layton/Price Waterhouse Coopers team to do an extended review of the entire procurement function, to include two years of data mining in connection with the various procurement mechanisms utilized by the Laboratory. Those include Blanket Purchase Orders, Just in Time contracting, and Local Vendor Agreements. The University of California and the Laboratory are committed to acting on any findings and recommendations resulting from that review, similar to the review of the purchase cards.

#### **The Mustang Case, G&G Tools, and Casino Advances**

Now I will turn my attention to the various purchase card transactions that have come to the attention of this Subcommittee.

#### *The Ford Mustang case*

With regard to the attempt to purchase a Ford Mustang using a Laboratory purchase card, I was advised of that case on July 25, 2002, by Stan Hettich, Procurement Group Leader, and Dennis Roybal, Deputy Division Leader for the Business Operations Division. They informed me that the Purchase Card Administrator, Ms. Arleen Roybal, had received a call from Bank of America on July 18 that informed her of the attempted Mustang purchase as well as vehicle accessories. The attempted purchases occurred during a period from May 3 through May 23, 2002, using the Laboratory purchase card issued in the name of a Laboratory purchasing official.

I was also told that the cardholder disputed the charges with Bank of America when the May purchase card statements were issued by the bank.

### *G&G Tools*

At the same June 25 meeting, Mr. Hettich advised me of other purchases made by the same cardholder over a two-year time frame. These included over \$1 million dollars in tools for our Engineering, Sciences and Application Division. I was not particularly surprised by the volume of tool purchases given the scope of engineering effort by this Division. I was taken aback by the fact that tools were purchased under our purchase card program instead of our Just in Time Program, which is the appropriate mechanism for tool purchases.

The Just in Time Program requires dye-marking of tools by vendors. The purchases were made under a limited exception granted by the procurement organization but the terms of the exception were not met. Moreover, I was surprised to find out that the cardholder had virtually unlimited purchasing authority levels. This particular cardholder had a single transaction limit of \$50 thousand and her monthly limit was \$900 thousand.

I directed Mr. Hettich to notify both Audits and Assessments and Security Division. I followed up a few days later with Mr. Hettich and he advised me that he had, in fact, notified Mr. Walp and Gil Griego of the Audits and Assessments office. Also on July 25, 2002, I notified Mr. Salgado and advised him that I had directed Mr. Hettich to notify Audits and Assessments and Security Division. Mr. Salgado pointed out to me that the Department of Defense was undergoing critical reviews of their purchase card programs and he asked me for a briefing on the purchase card process and procedures. Mr. Vern Brown, Mr. Hettich and I briefed Mr. Salgado on July 29.

### *The Casino Advances*

On or about August 9, Dennis Roybal, Deputy Division Director of the Business Operations Division, advised me of casino advances made under a Laboratory Purchase Card issued to Ms. Mary Frances Woods. Apparently this surfaced as a result of a desktop audit done by the Purchase Card Office on past transactions. Eleven cash withdrawals at three New Mexico casinos were made in the amount of \$1,400 between March 19 and April 26, 2002. I was told that the purchase card office had directly notified Mr. Doran but, similar to the Mustang case, I asked Mr. Roybal to notify Audits and Assessment and Security Division and I notified Mr. Salgado. Ms. Woods was placed on administrative leave on August 19 and subsequently terminated.

What particularly troubled me about this notification was that Ms. Woods was a contractor employee assigned to the Procurement Group Leader's Office. I was even

more concerned that Mr. Stan Hettich, Procurement Group Leader, was listed as the approving official for Ms. Woods' purchases. I later discovered that Ms. Woods, as well as other personnel in the procurement organization, could 'self approve' their purchases.

Some time between the date (July 25, 2002) I was informed of the Mustang case, and August 26, 2002, I took two actions that are relevant to your inquiry here.

- One, I assigned John Tapia as the single point of contact for purposes of information flow to Security Division regarding property management, purchase cards, as well as the Mesa contract. Frankly, I was concerned about a possible conflict of interest in the procurement group given the fact Stan Hettich was shown as an approving official for Ms. Woods. I did not want to compromise any ongoing law enforcement investigations. I personally called the Purchase Card Administrator, Arleen Roybal, and advised her that she was to give full cooperation to Mr. Tapia and the Security Division.
- Two, I advised Mr. Salgado on the details I had regarding the Mesa Contract and the purchase card incidents. It was difficult at that time to know whether any of these were related incidents or how rampant the problem was. Mr. Salgado was equally concerned and he and I agreed to a two-fold strategy, which involved an immediate fix to the purchase card policies and procedures and an in-depth review of purchase card transactions to see how widespread the purchase card abuse problem was.

#### *Purchase Card Policies & Procedures*

First, we agreed to appoint an internal committee to take a critical look at our current purchase card procedures and recommend immediate changes that addressed problems such as the purchase card authorities and limits, lack of approving officials, and receipt of property ordered. That committee consisted of John Tapia, Laboratory Counsel Frank Dickson, and the former Contracts and Procurement Director of the NNSA's Albuquerque Operations Office, Mr. William Meyers, who serves as a consultant to me on special assignments. I chartered that committee and directed them to thoroughly study the most current Department of Defense OIG reviews and the recommendations from those studies. Based on those recommendations, and after feedback from Laboratory Division Directors, I issued revised Purchase Card Procedures on August 26, 2002.

#### *The Layton Committee*

Second, it was agreed that Joe Salgado would have a conversation with John McTague, the former University of California Senior Vice President for Laboratory Management about the establishment of an external review committee to do a thorough review of the Laboratory's purchase card program. After Mr. Salgado and Mr. McTague discussed the idea, it was decided that McTague would direct the Laboratory to form such a team and direction was given accordingly. A team was put in place by the Laboratory which was led by former DOE Inspector General John Layton and supported by the University of California's audit firm of Price Waterhouse Coopers to do a thorough review of purchase card purchases over the past few years.

On August 26, 2002, Mr. Salgado chartered that committee and the committee began its methodical review of some 170 thousand transactions and \$120 million dollars worth of



purchase card activity covering the period from October 1, 1998, through June 30, 2002, a forty-five month period. The Layton Committee issued a formal report of its findings on December 12, 2002, and, in addition to several findings and recommendations, referred \$4.9 million in transactions to the Laboratory for further disposition, including several which they suggested for referral to the Office of Inspector General.

### *The Laboratory's Management Response to the Layton Committee Report*

By memorandum dated December 9, former Laboratory Director John Browne formally tasked me to respond to the Layton Committee report. The memorandum was premised upon a November 20 draft report issued by the Layton Committee to Joe Salgado. My assignment was to reconcile all purchase card accounts that had not been reconciled, resolve all questionable purchase card transactions, and otherwise address the Layton report findings and recommendations. Shortly after that time, Joe Salgado requested that the University of California independently audit the Laboratory's management response to the Layton Committee report.

In anticipation of that requirement, on December 4, I issued a Laboratory-wide data call for documentation required to validate purchases called into question. On December 6, I formed a Project Team, led by Jay Johnson, Acting Controller in Business Operations Division, to methodically address each and every questioned transaction and account. On December 13, I again made a Laboratory-wide request for documentation based on preliminary conversations with Patrick Reed as to the extent of documentation he required to satisfy his audit methodology. He wanted convincing documentation relative to software licensing purchases and items that the Layton Committee considered questionable. The Laboratory cooperation was overwhelmingly positive, the project team worked incredibly long hours under arduous conditions, and we concluded our project on January 31, 2003.

Mr. Reed issued an interim audit report on February 10, 2003. His report concluded that we had provided adequate documentation or justification to support all but around \$200 thousand in purchase card purchases. As reported by Mr. Darling, the University of California plans to reimburse the NNSA for those costs.

### *Laboratory Purchase Card Program Corrective Actions*

Now that we have both the Layton report and the Reed report, we are developing an action plan that integrates the recommendations and implements corrective actions. In addition to the changes articulated in my August 26 announcement of purchase card changes, we have implemented many fixes already but I know we still have a ways to go before we have a program that is sustainable.

- We have made current all of our reconciliations, eliminating a significant backlog of reconciliations.
- We have re-formed the Purchase Card Program office, providing new interim leadership and staff to work off the corrective actions and develop robust administrative tools including monthly and quarterly audits.
- We have completed purchase card refresher training for all Laboratory card holders and approving officials. We have suspended cards for failure to meet the training requirements.

- We have dropped the number of purchase card holders from over a thousand to around 585.
- We have begun to design automated systems changes that will eliminate the need for manual reconciliation and to enhance internal controls features.
- We have collaborated with Livermore National Laboratory and Lawrence Berkley Laboratory to establish standardized University of California purchase card policies.

In addition, I have shared with NNSA Headquarters and the Los Alamos Site Office some Lessons Learned which might be of use to the rest of the Nuclear Weapons Complex M&O contractor sites.

### **Other Corrective Actions**

#### *Wall-to-Wall Inventory*

When John Browne tasked me to respond to the Layton Committee report on December 9, he also assigned me several actions related to property management. The key assignment required revised Laboratory procedures for:

- ensuring that controlled property is entered into the inventory at the time of receipt, regardless of how purchased;
- periodic reconciliation of property records with procurement records;
- assuring that the Security Division, line managers, and property custodians take prompt action to find unlocated property;
- assuring that spot and random property audits are completed; and
- addressing any other property management issues that I found warranted action.

My evaluation of the property management issues surrounding this assignment made me realize that, as an institution, we were not prepared to implement 'fixes' without a thorough understanding of the problem. In my opinion, it was a matter of 'first things, first', and I thought it would be wise to scope the magnitude of the problem through a wall-to-wall inventory. I was not comfortable with the current use of accountability statements given the lack of public credibility in our property management controls.

After a follow up meeting in December with John Browne and Joe Salgado, we concluded that the appropriate course of action was a wall-to-wall property inventory. I directed the Property Management Group to develop a wall-to-wall inventory project plan, which I subsequently approved, and on February 3, that wall-to-wall inventory was initiated. The methodology and the results will be validated by Price Waterhouse Coopers and the NNSA.

As of today's date, we have inventoried over 70% of the 84,000 controlled property items in our inventory. We have accounted for over 70% of the cost of our controlled inventory, which is approximately \$940 million.

#### *Cradle-to-Grave Supply Chain Integration*

We are also finding items in our Laboratory sweep that were not originally bar-coded. This underscores the importance of reviewing the cradle-to-grave process of supply chain management at the Laboratory. We need to formalize and integrate the steps that lead from ordering, to purchase, to receipt, to accounting, to entry into the inventory, to

reporting as lost or stolen, and, where necessary, the need to institute individual accountability.

In January, I chartered a team of Laboratory personnel to re-engineer the entire supply chain so that it is integrated and visible to the entire Laboratory. That team is led by Carol Smith, our very capable Warehouse Manager, and her team is expected to provide a report within the next few weeks.

#### *Drop Point Survey*

In my opinion, the single largest vulnerability of the Laboratory's property management system is the fact that, at our 43-square-mile Laboratory, it is not feasible to have a single warehouse as the sole location for delivery of property.

As a part of the business and financial improvements that Bruce Darling discussed at the February 26 Subcommittee hearing, the Laboratory has also performed a survey of its 580 property delivery points which are referred to as 'drop points'. The Business Operations Division surveyed each of those points to assess the security, the volume, and the safety and housekeeping issues. I expect a report soon with their recommendations for improvement and tighter control but in the interim the number of drop points have been reduced to 440 and we have re-instituted clear accountability of control of these points by building and facility managers.

#### *Clarification of Reporting Lost and Stolen Property*

The DOE OIG special inquiry found a substantial degree of "dysfunction" with respect to roles and responsibilities regarding loss and stolen property. As indicated by Mr. Darling in his February 26 testimony, the Laboratory has clarified that lost and stolen property is to be reported to the Office of Audits and Assessments, which now directly reports to the University of California Office of the President.

#### *Management of Data*

The two external review teams that are reviewing property and procurement data have expressed concern regarding the Laboratory's ability to produce consistent and reliable data without significant manual manipulation of data. In essence, this was the root cause of the primary finding of the recent OIG review of our firearms inventory---we were unable to document the inventory of a dozen Glock handguns that were stuck in a property accounting backlog. In too many instances we have Laboratory business and financial personnel trying to 'muscle' inadequate data systems on old information platforms. The Laboratory is embarked on an Enterprise Resource Project that will modernize our management of business and financial data. This will help us document the right kinds of data and provide managers timely and access to quality data they need to make resource management decisions and better control assets and accountability for those assets.

#### *Sanctions and Accountability*

There have been legitimate concerns raised by this Subcommittee and others regarding individual accountability for Government property and the sanctions in place for violation of Laboratory procedures. I believe that our current disciplinary policies provide for such

accountability but our practice in consistently enforcing sanctions needs improvement. Interim Director Nanos has a Laboratory-wide initiative in place to study all of our policies and he has indicated clear support for enforcing accountability in connection with our Federal stewardship responsibilities.

### **Conclusion**

Let me close by assuring you that the Laboratory is committed to correcting the many vulnerabilities in our business operations. I am highly encouraged by the resolve and commitment the University of California has shown in vigorously supporting positive change. I am proud of my association with the many thousands of honest and dedicated employees who have been working long hours, day after day, to regain the credibility of our neighbors, our customers, and the American taxpayers.

We can fix processes and we can apply technology to the problem of internal controls, but we would fail again as a Laboratory if we don't heed the real lesson learned from this experience. *People are our most effective internal control.* It is precisely because we do not have a 'culture of thieves' that there was not a greater exploitation of the flaws in our processes and the breakdown of our business practices.

The most recent Harvard Business Review has an article entitled, *Predictable Surprises: The Disasters You Should Have Seen Coming*. It makes the point that organizational vulnerabilities are often the toughest to overcome but that, by actively encouraging people to speak up, executives can bring to the surface many problems that might otherwise go unmentioned. I think Interim Director Nanos recognizes this as a value and has taken actions that acknowledge this by creating an open environment that celebrates the fact that people are now bringing issues forward. This is the point that DOE Inspector General Greg Friedman made in his testimony about changing the culture and acting on employee concerns.

Thank you for the opportunity to present testimony.